Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFP:JAX:NAS:TL-N-1640-01
VCBrooks ID# 58-08809:BAD

date: JUL 19 2001

to: James M. Hare
Financial Services and Health Care Group 1266
801 Broadway, MDP 21
Nashville, Tennessee 37203

from: Associate Area Counsel (Industry Programs) Area 3 - Nashville

subject: [redacted]-Form 1120 for [redacted]
[redacted]-Form 1120 for [redacted]
EIN: [redacted] and [redacted]

This is to advise that our National Office (CC:CORP:BO5) advised us on July 6, 2001, that it concurred in the conclusion in our memorandum of June 26, 2001, that the taxpayer had effectively waived the [redacted] and [redacted] NOL carrybacks under I.R.C. § 172(b)(3).

In concurring in our conclusion the National Office wished us to supplement our opinion by emphasizing: (1) that the return for each year was filed by the common parent of the consolidated group and (2) Treas. Reg. § 1.1502-21(T)(b)(3) did not apply to NOLs arising in a consolidated return year for which the due date of the income tax return is before August 26, 1996. See Treas. Reg. § 1502-21T(g)(4). Thus, the regulation did not apply to the [redacted] return.

Although the regulation did apply to the [redacted] return the National Office agreed with our conclusion that the facts of the

case demonstrate that the taxpayer substantially complied with the requirements of the regulation even though the statement referred to therein was not attached to the return.

Accordingly, we are closing our file on this aspect of the case. However, do not hesitate to seek our further assistance on any question regarding the computation of the consolidated income for the years involved or any other matter in the case.

HARMON B. DOW
Associate Area Counsel (Industry Programs)
LMSB Area 3: Retail, Food & Pharmaceuticals

By: /s/ Vallie C. Brooks
VALLIE C. BROOKS
Industry Counsel (Health Care)

cc: Harmon B. Dow, AAC (IP) LMSB:RFP:Area 3 (via email)

Benjamin A. De Luna, AAC (LMSB) RFP:Area 3 (via email)

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date: JUN 20 2001

to: James M. Hare
Financial Services and Health Care Group 1266
801 Broadway, MDP 21
Nashville, Tennessee 37203

from: Associate Area Counsel (Industry Programs) Area 3 - Nashville Health Care

subject: [redacted]-Form 1120 for [redacted]
[redacted]-Form 1120 for [redacted]
[redacted]
[redacted]
EIN: [redacted] and [redacted]

This is in reply to the memorandum from Revenue Agent Marti Slagle requesting our opinion on the issues stated below.

ISSUES

1. Whether the taxpayer properly elected to waive the carryback of an NOL on its Form 1120 filed for each of the taxable years [redacted] and [redacted] under I.R.C. § 172(b)(3) by checking box 14 on each return; and

2. If so, whether that election is binding, thereby preventing the taxpayer from changing the election to carryback the NOLs to years in which it has agreed to adjustments determined as a result of an examination of such returns.

CONCLUSION

By checking the box on Line 14 of the Form 1120 for each year, the taxpayer made an irrevocable election under 172(b)(3) to forego the carryback period for the NOL. The fact that the taxpayer did not attach the statement described in Temporary Regulations section 301.9100-12T(d) or Treas. Reg. § 1.1502-21T(b)(3)(i) does not invalidate the election for the reasons discussed below. (While the consolidated return for [redacted] was filed by the first group named above and the return for [redacted] was

filed by the successor second group, since the issue raised with respect to each return is the same, use of the term "taxpayer" in our discussion is intended to refer to each group's election. We also note that our opinion is limited to the validity of the election only and is not intended to imply approval of the taxpayer's computation of income and deductions on the returns involved under the complicated rules of I.R.C. § 1502 and the Regulations thereunder.)

FACTS

According to the memorandum from Revenue Agent Slagle, the taxpayer filed a Form 1120 for [redacted] in which it reported a net operating loss of $[redacted]. For the short period ending [redacted] the taxpayer filed a Form 1120 reporting a net operating loss of $[redacted]. On each of the consolidated returns, the taxpayer checked box 14 on Schedule K, page 3, which is preceded by the following instructions: "If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here." The instructions accompanying the Form 1120 for each of the two years instructs the taxpayer to check the box on line 14 if the corporation elects under I.R.C. § 172(b)(3) to forego the carryback period for an NOL. The instructions specifically state that "If you check this box, do not attach the statement described in Temporary Regulations section 301.9100-12T(d)."

According to Revenue Agent Slagle, the taxpayer included the NOL reported on its [redacted] consolidated return on its [redacted] consolidated return as part of the net operating loss deduction. In response to our request, Revenue Agent Slagle has forwarded us a copy of the pertinent part of the Form 1120 for [redacted] and a breakdown of the net operating loss deduction claimed thereon against taxable income of $[redacted]. On its [redacted] return in box 15 of Schedule K the taxpayer stated that the available NOL carryover from prior tax years was $[redacted] which figure coincides with the amount carried over from [redacted] after the taxpayer had claimed a net operating loss deduction for such year which included a portion of the NOL reported on the [redacted] return. Revenue Agent Slagle has also forwarded pertinent portions of the [redacted] Form 1120 filed by the taxpayer which reflects a loss of $[redacted] but no election by a check in box 14 of Schedule K, which is further evidence that the taxpayer was aware of the significance of checking box 14.

During the examination of the Forms 1120 for [redacted] through [redacted], in connection with this Joint Committee case, the examination team raised two major adjustments: (a) a claim of right income adjustment "due to/from governmentals" in the amount of about $[redacted], and (b) a SCRUB (or Tru Up) adjustment of

about $[redacted] which the taxpayer was not able to verify as a loss or a write-down for tax purposes. In response to your request, the undersigned held several conferences with the examination team to discuss the merits of each adjustment and thereafter concluded that the adjustments were justified based on the available evidence. In subsequent conferences with Group Manager Jim Hare, we advised that while the examination team could not grant the taxpayer the four year spread asked for on the "due to/from" adjustment, the adjustment could be reduced as well as the SCRUB adjustment based on additional records submitted by the taxpayer in order to arrive at an agreed case.

In subsequent conversations with Mr. Hare and the examination team, we have been advised that an agreement had been reached with the taxpayer's representative with respect to each adjustment, whereby the original amounts had been substantially reduced. Following the agreement, the taxpayer has raised for the first time the position that it is entitled to change the election made on the [redacted] return and the [redacted] return to forego the NOLs for prior years, and therefore is entitled to carryback the loss agreed upon for each of such years. The taxpayer contends that the fact that it checked the box to forego the carryback does not override the regulations which require a statement attached to the return to make the election, and therefore the election by checking the box was invalid.

ANALYSIS

Section 172 of the Internal Revenue Code allows a net operating loss deduction equal to: (1) the net operating loss carryovers to such year, plus (2) The net operating loss carrybacks to such year. Under I.R.C. § 172(b)(1) for the years involved, a net operating loss may be carried back to each of the three taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the fifteen taxable years following the taxable year of the loss.

Section 172(b)(3) provides that a taxpayer may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year. Such section further provides that the election shall be made in such manner as may be prescribed by the Commissioner and shall be made by the due date for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect. The section further provides that such election, once made for any taxable year, shall be irrevocable for such taxable year.

The instructions accompanying the Form 1120 for [redacted] and

[redacted] contain the following paragraph with respect to the answer to question 14 on Schedule K of the Form 1120:

> **Question 14 (Form 1120 Only)**
>
> Check the box on line 14 if the corporation elects under section 172(b)(3) to forego the carryback period for an NOL. If you check this box, do not attach the statement described in Temporary Regulations section 301.9100-12T(d).

The regulation referred to in the above instruction is quoted below:

> (d) Manner of making election. Unless otherwise provided in the return or in a form accompanying a return for the taxable year, the elections described in paragraphs (a) and (c)(except paragraphs (c)(1)(i) and (c)(5)) shall be made by a statement attached to the return (or amended return) for the taxable year. The statement required when making an election pursuant to this section shall indicate the section under which the election is being made and shall set forth information to identify the election, the period for which it applies, and the taxpayer's basis or entitlement for making the election.

The above regulation makes it clear that the return or a form accompanying the return, such as the instructions quoted above, may eliminate the requirement of making the election on the statement attached to the return. Since the instructions accompanying the Form 1120 pertaining to question 14 specifically state that if the taxpayer checks the box it did not have to attach the statement described in the Temporary Regulations, the election by checking the box was in accordance with the regulations. Thus, the taxpayer's argument that checking the box does not override the regulations is not a valid one.

On [redacted], in a telephone conversation with Revenue Agent Mike Prespare', also assigned to this case, we reconfirmed our earlier stated opinion that the taxpayer had made a valid election which was irrevocable. Mr. Prespare', however, requested that in addition to the Temporary Regulations quoted above that we consider Treas. Reg. § 1.1502-21T(b)(3)(i) which reads as follows:

> (3) Special rules-(i) Election to relinquish carryback. A group may make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period

> with respect to a CNOL for any consolidated return year. The election may not be made separately for any member (whether or not it remains a member), and must be made in a separate statement entitled "THIS IS AN ELECTION UNDER SECTION 1.1502-21T(b)(3)(i) TO WAIVE THE ENTIRE CARRYBACK PERIOD PURSUANT TO SECTION 172(b)(3) FOR THE [insert consolidated return year] CNOLs OF THE CONSOLIDATED GROUP OF WHICH [insert name and employer identification number of common parent] IS THE COMMON PARENT." The statement must be signed by the common parent and filed with the group's income tax return for the consolidated return year in which the loss arises.

While the above regulation is more specific in its directions on how to make an election to relinquish a carryback on a consolidated return, we believe that it is subject to the same interpretation and the same instructions discussed above regarding an election of an NOL on a non consolidated return.

We first note that the regulation specifically refers to the irrevocable election under section 172(b)(3) to relinquish the carryback of the NOL. Thus, it would follow that the principles used to determine the validity of an election under section 172 with respect to a consolidated return are the same as with respect to any other type of return. We believe this logical conclusion is encompassed in Treas. Reg. § 1.1502-21T(b)(1) which provides that the net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and such section of the regulations.

Although there does not appear to be a case involving an election to waive consolidated NOL carrybacks, there are several cases that have considered the effectiveness of a taxpayer's election to waive NOL carrybacks with respect to other returns. In those cases, the courts have held that the essence of the election is that a "taxpayer unequivocally communicates his election and binds himself to his decision concerning the best use of his net operating loss." See Young v. Commissioner, 783 F.2d 1201, 1206 (5th Cir. 1986), 86-1 U.S.T.C. ¶9255 and Harding v. Commissioner, T.C. Memo. 1999-378.

Here, the taxpayer admits that it intended to make an election to waive the carryback of the NOL reported on the Form 1120 by checking the box, but now maintains that the election was invalid because it did not attach the statement referred to in the regulation. In other words, the taxpayer seeks to avoid the intended election through the pretext of its failure to follow a required procedural rule even though it is not deemed as such by the Commissioner for the reason that "No agent auditing [either]

tax return could possibly have been misled as to [the taxpayer's] intention." See Santi v. Commissioner, T.C. Memo. 1990-137.

The taxpayer's argument here has no more validity in our opinion than a taxpayer's attempt to void a determination by the Service for its failure to follow a procedural rule. See Estate of Ralph L. Jones v. Commissioner, 795 F.2d 566 (6th Cir 1986) aff'g T.C. Memo. 1984-53, and cases cited therein, holding that IRS Procedural Rules are only directory and not mandatory.

In Carlstedt Associates, Inc. v. Commissioner, TC Memo. 1989-27, the Tax Court concluded that the taxpayer must report his commission income on sales in the year received even though subsequent refunds of the commissions might be necessary. As a result of such conclusion, the taxpayer argued that it should be relieved from its election to relinquish its right to carryback a net operating loss sustained in its 1992 year because such election was made under mistake of fact as to the magnitude of its 1992 operating loss. The taxpayer's president testified that he would never have agreed to giving up the opportunity to carryback substantial losses if he had known that the Commissioner would successfully challenge its deferral of the commission income in the amount of $420,000. In response to such argument, the Court held that the intent of the taxpayer's president or its accountant is irrelevant to the determination of whether a valid and binding election was made under section 172(b)(3)(c). The Court noted that the taxpayer and its president simply misapplied the law to a fixed set of known facts and it was this misapplication of federal income tax law which caused the taxpayer to misjudge the extent of the losses in electing the benefits of section 172(b)(3)(c). The Tax Court held that the taxpayer should not be allowed to undo an irrevocable election simply because the election later turned out not to be as beneficial as expected.

The facts in the instant case are similar, if not identical, to those in the Carlstedt Associates case. Here, it is clear, as found by the court in the Carlstedt Associates case, that the taxpayer's intent was unambiguous on the face of the return and binding to waive the carryback of its [redacted] NOL and [redacted] NOL. This intent is further evidenced here by the fact that the taxpayer actually applied the [redacted] NOL to eliminate a portion of the [redacted] tax liability.

The fact that the current examination of the taxpayer's returns has resulted in an adjustment which would make it more advantageous for the taxpayer to carryback the [redacted] NOL and [redacted] NOL does not allow the taxpayer to undo the election. Otherwise, the provision in the statute that such an election, once made, is

irrevocable would be meaningless, regardless of whether the election is made on a Form 1040 such as in Harding v. Commissioner, supra, or a Form 1120 such as in Carlstedt Associations, Inc. v. Commissioner, supra.

While you do not have the authority to allow the taxpayer to undo the election, we suggest that you consider giving the taxpayer an opportunity to readdress the major adjustments agreed upon if it feels that it would not have reached such agreement if it had known that it could not revoke the waiver. Based on the telephone conversation between Group Manager Hare and the undersigned on or about [redacted], the taxpayer seemed to be pleased with the resolution of the adjustments agreed upon. Thus, a gesture to reopen the negotiation of these amounts, in our opinion, might cause the taxpayer to reconsider its attempt to revoke the election.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, including the attorney/client privilege. If disclosure becomes necessary, please contact this office for our views.

Since our conclusion here may be a significant one with respect to elections on consolidated returns, we are forwarding our opinion to our National Office for post review.

We hope to advise you of the National Office's reply within 20 days. In the meantime, if you have any questions, do not hesitate to telephone the undersigned any time at (615) 250-5509.

HARMON B. DOW
Associate Area Counsel (Industry Programs)
LMSB Area 3: Retail, Food & Pharmaceuticals

By: /s/ Vallie C. Brooks
VALLIE C. BROOKS
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